TOWARDS SUSTAINABLE ASEAN DEVELOPMENT: IMPROVED BUSINESS ENVIRONMENT IS THE KEY TO FDI, NOT TAX COMPETITION

By Pham Quang Tu, Deputy Country Director of Oxfam in Vietnam, Hanoi, November 11th 2020

Dear distinguished guests, ladies, and gentlemen, welcome

It is truly an honor to have you here contributing to the very important discussion today on sustainable policies in the ASEAN region *for improved business environment to attract FDI.*

The health and economic crisis emanating from Covid-19 has posed enormous challenges for sustainable Development in ASEAN region. With economic inequality already high, it is estimated that poverty and inequality will further be exacerbated due to Covid-19.

In June this year Oxfam and Partners published a research 'Towards Sustainable Tax Policies in ASEAN' and recently we have concluded a research paper on the flow of foreign direct investment, business environment and non-tax incentives in the ASEAN region.

The ASEAN region is experiencing unprecedented economic inequality, as some countries still have the highest poverty levels in the world and most countries in the region are failing to invest sufficiently in essential public services. The most worrying aspect is that this lack of spending is being seen at a time when countries in the region already seeing their fiscal space stretched. Even before the COVID 19 pandemic, the situation in ASEAN was already unsustainable. Now the situation is even more dire. Initial estimates from the OECD[i] predict that the pandemic will have significant negative impacts on tax revenues, while at the same time budget burdens will increase due to governments' efforts to introduce supportive packages to help cope with the disease.

Just like in many other regions in the world, countries in the ASEAN region are competing with one another in a race to the bottom by reducing their CIT rates and offering aggressive tax incentives to foreign multinational corporations. Across the region, the average CIT rate has fallen over the last ten years from 25.1% in 2010 to 21.7% in 2020. Offering tax incentives can produce negative externalities that are detrimental to economic efficiency. The existence of tax incentives is likely to shift the focus of companies from expanding production to minimizing tax bills. Besides tax incentives, the use of non-tax incentives has been widespread among ASEAN countries and exacerbated the race to the bottom in the region. The competition in providing non-tax incentives is centred on land incentives.

A large proportion of FDI into Singapore was soon reinvested in other countries so that the businesses could enjoy enormous tax incentives offered by Singapore. Singapore's function as an intermediary investor can be damaging to the tax bases of other countries since it gives investors opportunities to avoid paying taxes in the host countries[1]. Empirical work suggests that business environment indicators are key determinants of FDI location decisions. Results from analyses of correlation between business environment and FDI attraction also indicate positive associations between FDI location decisions and drivers of macroeconomic environment, institutional quality, and market development.

Despite the importance of ameliorating the business environment, ASEAN governments tend to focus more on competing in a harmful race to the bottom by offering excessive tax and non-tax incentives to attract FDI.

The ASEAN Member States need to react at the political level to stop the race to the bottom. No evidence suggests that tax incentives and non-tax incentives especially site incentives are seen by foreign investors as a key factor in their decision-making process. Indeed, tax incentives can even become obstacles in certain cases[2]. In view of the above facts, this research makes the following recommendations: Draw up a whitelist and a blacklist of tax incentives; Stop the competition in providing site incentives; Agree on a minimum tax standard across the ASEAN region; Establish rules for the good governance of investment incentives and Agree upon improving business environment, focusing on the key factors

It is high time for all ASEAN Member States to collaborate with one another to improve business environment and agree upon common minimum standards for corporate tax and non-tax incentives in the region to prevent harmful practices that drain essential public revenue and create unnecessary tax competition among members, and to achieve a common goal of building a sustainable and resilient region.

More details will be shared in a presentation from VEPR and The Prakarsa, and a roundtable with a panel of experts who will share their perspective and experience on business environment ad tax competition.

Wishing us all a very fruitful meeting

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i. OECD (2020), Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience. https://read.oecd-ilibrary.org/view/?ref=128_128575-o6raktc0aa&title=Tax-and-Fiscal-Policy-in-Response-to-the-Coronavirus-Crisis.

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[1] **Damgaard, J., T. Elkjaer, and N. Johannesen. (2019). *The Rise of Phantom Investments. Finance & Development*, 56(3).**

[2] **James, S. (2014). *Tax and non-tax incentives and investments: Evidence and Policy Implications*. Investment Climate Advisory Services. World Bank Group.**